



Statement of the Chamber of Commerce of the United States

ON: FEDERAL EMPLOYEE PENSIONS

TO: HOUSE POST OFFICE & CIVIL
SERVICE COMMITTEE

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TESTIMONY
on
FEDERAL EMPLOYEE PENSION
before the
HOUSE POST OFFICE & CIVIL SERVICE COMMITTEE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
Michael J. Romig
March 28, 1984

My name is Michael J. Romig. I am manager of the Employee Benefits and Human Resources Policy Center of the U.S. Chamber of Commerce. The center is responsible for developing positions on employee benefit issues for the Chamber. I appear here to express the Chamber's views on how to revise the federal employee pension system as a result of the decision to require new federal employees to participate in Social Security.

We are pleased to have this opportunity to participate in a unique and historic opportunity to address the needs of the federal government's largest and most expensive employee benefit program--the civilian pension programs provided to over 2 million employees. As Committee Chairman William D. Ford indicated, Congress faces a difficult, but not impossible, task of redesigning the civilian pension system to accommodate the Congressional decision of 1983 to gradually phase the federal civilian workforce into Social Security. In so doing, Congress, under the leadership of this committee and its Senate counterpart, must carefully balance the needs and wishes of two distinct groups of federal employees and weigh this against public demands for a less costly retirement system. Also to be considered is the government's need for a pension system that is manageable, nondiscriminatory and complementary to its employee recruitment and retention policies. Although this appears to be a mission impossible, we think it can be accomplished and we are happy to share our thoughts on how to do it.

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We also wish to compliment the members of this Committee for their decision to approach this responsibility in a carefully considered and deliberative manner. Retirement is a major component of federal employees compensation package and a significant cost to taxpayers. More importantly, it represents the nation's largest pension program providing significant retirement income protection to millions of retired Americans and many millions more to come.

SUMMARY

The Social Security Amendments Act of 1983 set the stage for Congress to address a myriad of problems plaguing the federal civilian retirement program. The task of designing a new supplemental pension program for all federal employees who began their employment since January 1, 1984 can and should be the first step toward bringing order to what heretofore has been a chaotic pension system for federal employees. Rather than design this new system to match the much criticized existing civilian retirement programs, we recommend that focus be placed on comparability with the private sector. Then this new program would serve as a benchmark for bringing comparability to existing programs.

THE CHALLENGE

With the enactment of Public Law 98-21, the stage was finally set for addressing a myriad of problems that have plagued the federal retirement system for several decades. The litany of complaints, documented by a number of commissions, boards and others, revolve around three findings:

1. Unfunded liabilities (i.e. the estimated future cost of all accrued pension benefits) now exceeds \$1 trillion for all federal--civilian and military--pensions. That is an IOU legacy from us to our children and their children and it will grow unless we take steps to stop it.

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2. Federal pensions are seen as much too generous when compared to those in the private sector.
3. Federal retirement programs lack an overall, coherent, coordinated policy that treats employees equally and recognizes the legitimate interests of management and taxpayers.

All three can now be addressed as we proceed to implement a new federal retirement program for all who entered federal service since January 1, 1984. Indeed, as we see it, there is no way to avoid responding to these complaints if we are to win both taxpayer and employee support for the new system.

Therefore, our recommendation to you is to design a pension program for new employees recognizing that changes in the existing retirement programs will also be necessary. Without such changes, public pressure to scrap both new and existing programs will intensify as costs continue to escalate and the gaps in comparability widen. Clearly, the preferred course is for Congress to design and develop a new overall civilian retirement system that is responsive to all considerations rather than acquiesce to abrupt changes responsive to annual budget considerations only.

NATIONAL RETIREMENT POLICY

Our nation's retirement policy envisions a three prong approach to meeting retirement income needs. First, there is to be a national system (Social Security and Medicare) that will meet basic needs and is earned through a career of employment. Because it is national in scope, it should apply to all employments and be portable from job to job. Currently, the largest gap in this protection is federal employees.

The second component is to be employment related pensions designed to complement Social Security's floor of protection. That is the primary mission of this Committee.

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The third component is to be personal savings and capital accumulation fostered by tax policies that reward savings and investment.

We fully endorse this policy and continue to believe it is in everyone's interest to bring current federal employees into Social Security. There is no compelling rationale for not doing so.

FEDERAL RETIREMENT POLICY

Looking at the existing hodgepodge of federal retirement systems, the disinterested observer would correctly conclude that there is no overall policy for federal pensions. Over 100 separate pension programs are maintained providing various groups of employees with inconsistent and differing benefits.

This Committee and Congress must use this opportunity to correct this situation both for new and current employees. We recognize that special retirement provisions may be justified for particular groups. For example, some would argue that the nature of the Foreign Service requires different treatment. However, the overall policy must emphasize that all federal personnel receive comparable and consistent benefits, absent a strong showing for special treatment.

COMPARABILITY

In addition to comparability among federal personnel, this Committee and Congress must strive to make federal pensions comparable to those in the private sector.

While there is a dispute over how to measure comparability, it can not be disputed that few private pensions match the generosity of most federal pension plans. As the President's Commission on Pension Policy noted, federal pensions in almost all respects are more favorable to the employee than are private pensions. Much of this disparity is traceable to the following:

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- . federal pensions provide unreduced early retirement benefits to a much greater extent than private plans;
- . federal pensions provide full annual protection against inflation, whereas private plans offer only partial protection;
- . federal pensions generally have more generous benefit calculation formulas than private plans; and,
- . the federal government does not have to fund its pensions on the same basis as the private sector.

The Chamber's overall policy goal is for full pay and benefit comparability. Achievement of this goal may be best achieved by seeking to match benefit for benefit and pay for pay. Hence, it would be our recommendation that you focus primarily on retirement comparability for purposes of this task, recognizing that future endeavors would require examination of other benefits and pay matters.

In offering this suggestion, we fully understand that overall benefit and pay costs can not be ignored entirely. But to attempt to resolve all disparities while resolving the pension dilemma will only mire Congress in a succession of debates. On this point, we agree with the Administration's observation that the differences are too pervasive to make a total pay and benefits overhaul practical in one package.

Our final recommendation on comparability is to use a broad cross section of private industry to make the comparison. Our own annual survey, a copy of which I have provided members of the Committee, includes a larger number of smaller firms than other studies. Because of the large number of people employed in small firms, a comparison that excludes these firms will be quickly discredited. Similar considerations apply for including local and state government pensions in the comparison.

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GENERAL DESIGN

You have asked us to comment on the general design of the supplemental system. Although we have not presented specific options to our policy committees and our Board of Directors, certain factors are going to be very influential in our deliberations on what kind of plan should be adopted. We think that they should weigh in your considerations as well.

(1) Defined Benefit vs Defined Contribution

The options are a defined benefit or a defined contribution plan, although a combination of the two can be selected. A defined benefit plan promises to pay a specified retirement benefit to all employees who meet the plan's service requirements. Most private sector plans aim for 50 percent of final average pay (last 5 years) for employees with 30 or more years of service. A lesser period of service produces a smaller pension while more years of service adds to the pension.

A defined contribution plan promises to make a specified pension payment for each year of service. The longer the years of service, the greater the pension. Under these plans, the actual annuity depends on how much has been accumulated and how much that amount can provide under market conditions at the time of retirement.

In the debate over which pension plan to choose, a fundamental point is often obscured. The point has to do with the difference between pension plans (defined benefit plans) and other forms of benefit plans (defined contribution plans) that can supply retirement income.

In a defined benefit plan, the employee is relieved of the risk of investment losses. That risk falls upon the employer who must make sure that his contributions and the investment earnings on them will be sufficient to pay the promised pension. If they are not, the employer must add funds from current earnings or other company assets. In the case of federal pensions, that obligation falls on the taxpayers.

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In a defined contribution plan, the employee bears the risk of total contributions and earnings on them adding up to an adequate pension. If earnings are good, the employee can count on a handsome retirement income. To hedge against poor earnings, larger contributions are generally made, if at all possible.

By the same token, although the employee under a defined contribution plan gets the benefit of investment gains, the employer under the defined benefit plan gets the benefit. In each case, the risk taker enjoys the rewards or suffers the consequence.

In essence, the trade-off is this: the employee in a defined benefit plan has security; the employee in the defined contribution plan is at risk. Under a defined contribution plan, an employee may make out far better than a similarly situated employee in a defined benefit plan, but he also may make out far worse. To put it another way, the employee under the defined benefit plan is entitled to a specific benefit. His security in that benefit is backed up by the company that sponsors the plan.

A defined benefit plan primarily serves the longtime employee and does little for the short-term employee, since the latter does not remain with the employer long enough to become vested. Because the current civil retirement system is a defined benefit plan, only 25 percent of those who enter the civil service ever draw retirement benefits. So, from an employees' perspective, a strong case can be made for switching the existing system to a defined contribution plan. Since the new employees will participate in Social Security, the case for a defined contribution plan would not be as strong since the portability of Social Security coverage assures accrual of some retirement credits by short-term employees .

From the taxpayer's perspective, defined contribution plans have other factors to recommend them. Chief among these is that such plans do not accumulate unfunded liabilities. With over \$1 trillion in federal liabilities, knowledge that the new system would not add to that burden would be persuasive.

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A combination plan is seldom found in the private sector beyond the very largest firms or among professional or highly profitable small firms. In these cases, the employer attempts to balance the interests of both short and long term employees.

(2) Eligibility and Participation

Private sector eligibility and participation rules are governed by ERISA and most private pensions simply meet these relatively liberal rules. We see no reason why the federal government should use a different set of standards.

(3) Inflation Protection

Cost-of-living adjustments (COLAs) have been a major cost factor for federal pensions and any change to the program must come to grips with this issue. Currently, we are advocating a one year freeze on all COLA's and indexing at 60% of the Consumer Price Index (CPI) thereafter. But even that is more generous than private sector plans. A recent Department of Labor study revealed that private pensions, on average, were able to match only 39% of CPI increase between 1973 and 1979.

(4) Financing

As indicated earlier, the financing of federal pensions is not comparable to the private sector. Perhaps it need not be since there is less chance of the federal government terminating its pensions for financial reasons than might be the case for private firms. Nonetheless, a \$1 trillion funding shortfall is staggering to contemplate. Certainly, it will hamper our efforts to curb inflation and eliminate deficits in the years ahead, but we must make a commitment to amortizing that liability. This commitment will also indicate to all current and future federal retirees that they need not fear for the fiscal integrity of their retirement plan.

(5) Coverage

As indicated at the outset of our statement, we are convinced that all federal employees should be covered by Social Security.

CONCLUSION

We are here today to deliver this message: The time for reform of federal pensions is at hand. The task begins with the design of a government-wide supplemental civil service retirement plan that is comparable to private sector pension plans rather than the overly generous existing civil service pension plans. This new system must be made to serve the interests of all new civilian employees, their managers and the taxpaying public. We pledge our support to your efforts to implement such a program.

Thank-you.

Figure 8
ACCUMULATED BENEFITS AND PRESENT VALUE OF BENEFITS BY YEAR
FOR A HYPOTHETICAL FEDERAL WORKER HIRED AT THE GS-9 LEVEL
ON JANUARY 1, 1984, WHO WORKS 10 YEARS AND RETIRES AT AGE 62

